



JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
OFFICE OF THE STATE BUDGET
LANSING

ROBERT L. EMERSON
DIRECTOR

December 31, 2008

The Honorable Jennifer M. Granholm, Governor
Members of the Legislature
People of the State of Michigan

As required by Article 9, Section 21, of the State Constitution and Section 494, Public Act 431 of 1984, as amended, we are pleased to submit the *State of Michigan Comprehensive Annual Financial Report* (SOMCAFR) for the fiscal year ended September 30, 2008.

INTRODUCTION TO THE REPORT

Responsibility: The Office of the State Budget, Office of Financial Management, prepares the SOMCAFR and is responsible for both the accuracy of the data and the completeness and fairness of the presentation, including disclosures. To the best of our knowledge and belief, the information contained in the SOMCAFR is accurate in all material respects and reported in a manner that fairly presents the financial position and results of operations of the State primary government and component units for which it is financially accountable. All disclosures necessary to enable the reader to gain a reasonable understanding of the State's financial affairs have been included.

Adherence to Generally Accepted Accounting Principles: As required by State statute, we have prepared the financial statements contained in the SOMCAFR in accordance with generally accepted accounting principles (GAAP) applicable to state and local governments, as promulgated by the Governmental Accounting Standards Board (GASB). The State also voluntarily follows the recommendations of the Government Finance Officers Association of the United States and Canada (GFOA) for the contents of government financial reports, and participates in the GFOA's review program for the Certificate of Achievement for Excellence in Financial Reporting.

Report: The SOMCAFR is divided into four major sections: introductory, financial, statistical, and other information:

- The introductory section includes this letter, the State's organization chart, and the list of principal officials.
- The financial section includes: the independent auditor's report on the Basic Financial Statements; Management's Discussion and Analysis (MD&A) which provides an introduction, overview, and analysis to the Basic Financial Statements; the Basic Financial Statements, which present the government-wide financial statements and fund financial statements for governmental funds, proprietary funds, fiduciary funds, and component units, together with footnotes to the Basic Financial Statements; Required Supplementary Information other than MD&A, which presents budgetary comparison schedules and information about infrastructure assets; and the supplemental financial data which includes the combining financial statements and schedules.
- The statistical section includes such items as trend information, information on debt levels, and other selected economic and statistical data.
- The other information section includes General Fund and Special Revenue Funds revenue and expenditure schedules and General Fund source and disposition of spending authorization schedules.

Internal Control Structure: The Office of the State Budget is responsible for the overall operation of the State's central accounting system and for establishing and maintaining the State's internal control structure. The system of internal control has been designed to provide reasonable rather than absolute assurance that the financial statements are free from material misstatement.

All financial transactions of the State primary government are recorded in the central accounting system, except for the Michigan Unemployment Compensation Funds, Attorney Discipline System, the State of Michigan Deferred Compensation Funds, the State of Michigan Defined Contribution Retirement Fund, and the Michigan Education Savings Program. Many of the essential control features are decentralized, such as the preparation and entry of expenditure transactions into the central accounting system. Consequently, the Office of the State Budget relies upon the controls in place at the various State departments and agencies.

The Management and Budget Act requires each principal department to maintain adequate internal control systems. Each department is also required to periodically report to the Governor on the adequacy of its internal accounting and administrative control systems and, if any material weaknesses exist, to provide corrective action plans and time schedules for addressing such weaknesses. This reporting is required on or before May 1 of each odd numbered year, effective as of the preceding October 1.

The discretely presented component units generally operate outside the State's central accounting system and are responsible for establishing and maintaining their own separate internal control structures.

Internal Auditors: Pursuant to Executive Order 2007-31, the Office of the State Budget provides internal audit services to executive branch departments and agencies. Office of the State Budget internal audit staff perform periodic financial, performance, and compliance audits of department and agency programs and organizational units. In addition to periodic audits, Office of the State Budget internal audit staff also review department and agency management's processes for establishing, monitoring, and reporting on internal controls; advise department and agency management on internal control matters; and assist department and agency management with investigations of alleged fraud or other irregularities.

Independent Auditors: The Office of the Auditor General (OAG) is the principal auditor of the SOMCAFR. The OAG also relies on the opinions of outside public accounting firms, particularly for component unit financial statements (such as the Michigan State Housing Development Authority and 10 of the State's universities), the larger pension and other employee benefit trust funds, and the Unemployment Compensation funds. The purpose of the OAG's audit is to provide reasonable assurance that the Basic Financial Statements for the fiscal year ended September 30, 2008 are free of material misstatements. The OAG concluded that the Basic Financial Statements for the fiscal year ended September 30, 2008 are fairly presented in accordance with GAAP and issued unqualified opinions.

In addition to the annual audit of the SOMCAFR, the OAG also performs periodic financial statement and performance audits of the various State departments, agencies, and institutions of higher education. The Auditor General also has primary responsibility for conducting audits under the federal Single Audit Act Amendments of 1996. Pursuant to Michigan Public Act 251 of 1986, these audits are conducted biennially for applicable State departments, agencies and component unit authorities, and result in separately issued audit reports.

Management's Discussion and Analysis (MD&A): GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the Basic Financial Statements in the form of MD&A. This letter of transmittal is intended to complement MD&A and should be read in conjunction with it. The MD&A can be found immediately following the Independent Auditor's Report.

PROFILE OF THE GOVERNMENT

Michigan was admitted to the Union as the 26th state in 1837. The State is governed under the Constitution of 1963, as amended.

Executive Branch: The Executive Branch consists of 18 principal departments. Fifteen principal departments are headed by commissions and/or directors appointed by the elected governor. Elected officials head two principal departments, Attorney General and State, and one, Education, is headed by an elected board.

Judicial Branch: The Judicial Branch consists of the Supreme Court, Court of Appeals, Court of Claims, and the State's circuit, district, probate, and municipal courts. In addition to its judicial duties, the Supreme Court is responsible for the general administrative supervision of all courts in the State. The Supreme Court also establishes rules for practice and procedure in all courts.

Legislative Branch: The Legislative Branch consists of the Senate, House of Representatives, and Office of the Auditor General. The Senate, which consists of 38 elected members, and House of Representatives, which consists of 110 elected members, enact the laws of Michigan. The Office of the Auditor General conducts post financial and performance audits of state government operations.

Reporting Entity: The financial reporting entity of the State includes all of the funds of the primary government as well as component units for which the State's elected officials are financially accountable. The transmittal letter, MD&A, and the financial statements focus on the primary government and its activities. Although information pertaining to the component units is provided, their separately issued financial statements should be read to obtain a complete overview of their financial position.

Budgetary Reporting and Control: For the State primary government operating funds (i.e., the General Fund and annually appropriated special revenue and permanent funds), the State budget projects revenues and expenditures and calculates fund balances for budgetary purposes in accordance with GAAP. Public Act 431 of 1984, as amended, prohibits the State from budgeting for an ending fund balance deficit in an operating fund. If an actual deficit is incurred, the Constitution and Act 431 require that it be addressed in the subsequent year's budget. If accounting principles change, Act 431 requires the State to also implement such changes in its budgetary process.

Compliance with the final updated budget for the annually budgeted operating funds of the State primary government is demonstrated in the budget and actual comparative schedules and notes in the SOMCAFR. In addition, subsequent to the

publication of the SOMCAFR, the State releases a Statewide Authorization Dispositions report that provides line item appropriation details, the legal level of budgetary control, for the General Fund and budgeted operating funds.

MAJOR INITIATIVES AND FUTURE PROJECTS

A Job For Every Worker: Rebuilding Michigan's economy requires continued efforts to diversify into new sectors where Michigan has a natural advantage, including alternative energy, life sciences, advanced manufacturing and homeland security. We must continue to ensure that workers have the skills they need to be competitive by providing access to education and training. And we must ensure that we can compete with other states and nations for jobs and investment by expanding our economic development toolbox.

Michigan's \$2 billion 21st Century Jobs Fund, our new Centers of Energy Excellence program and a host of new economic development tools brought more than \$5 billion in investment to Michigan this year, creating thousands of new jobs.

In fiscal year 2009, an additional \$15 million in state funding was added to the federal funding for No Worker Left Behind, an innovative program to help displaced workers connect to new careers by providing free training. Through November 2008, the program has enrolled more than 50,000 participants in training in high-demand fields.

Health Care for Every Family: During fiscal year 2008, the two departments primarily responsible for providing services to Michigan's most vulnerable citizens, the Department of Human Services and the Department of Community Health, saw the demand for their services increase as the economy grew more challenged. Despite a tight budget, no eligible citizen was denied health care, despite an increase in the average number of citizens eligible for Medicaid services of 43,000 per month.

In addition, more than 500 nursing home residents were transitioned back to community living as a result of the state's efforts to reform the long-term care system.

Quality Education for Every Child: The State is committed to providing every child with a quality education. As the foundation of our economic plan, over \$15.5 billion or 34.8% of the State's total fiscal year 2009 budget is devoted to educating Michigan's citizens through its public schools, community colleges, and universities.

The School Aid Budget, totaling \$13.4 billion, reflects the commitment to provide all students in the K-12 education system with the tools they need to succeed in a global economy. For fiscal year 2009, the minimum foundation allowance was increased to \$7,316 per pupil and an additional \$10 million was provided to make quality preschool accessible to more children.

The fiscal year 2009 budget also provided funding for the 21st Century Schools Fund to help Michigan school districts replace large, impersonal high schools that have low academic achievement and high dropout rates, with small high schools that use relationships, discipline, and relevance to help at-risk kids achieve.

To help make Michigan competitive, the fiscal year 2009 budget continues to invest in one of the state's largest economic catalysts – our universities. State colleges and universities will receive \$2.1 billion. In addition, more than \$230 million in grants and scholarships were made available to assist students in paying for higher education.

Efficient and Effective Government: During fiscal year 2008, the Granholm Administration continued their efforts to streamline government, reduce costs and improve efficiency. Through Executive Directive in 2007, Governor Granholm set a goal of reducing energy usage at state facilities by 10 percent by the end of 2008. Already, the state has reduced energy usage by nearly 18 percent, saving \$21 million. The state has also joined the Climate Savers Computing Initiative to reduce energy usage by the state's 55,000 desktop computers and 3,700 servers, saving an additional \$1 million.

Additional technology usage is improving customer service, reducing permitting time and saving the state money. The new CHAMPS and BRIDGES databases for Medicaid and cash assistance programs, respectively, will help improve data collection and sharing, reduce paperwork and speed eligibility determination. In addition, a new web portal in the Department of Treasury helps local units of government file audit information easier and quicker while new technology at the Department of Agriculture has reduced permitting time for businesses including grocery stores, restaurants and gas stations by 50 percent.

AWARDS AND ACKNOWLEDGEMENTS

Certificate of Achievement: The GFOA awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Michigan for its SOMCAFR for the year ended September 30, 2007. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report whose content satisfies both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The State has received a Certificate of Achievement for 21 consecutive years. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments: The preparation of this report requires the collective efforts of the management and staff of the Accounting and Financial Reporting Division, Office of Financial Management; the chief financial officers, chief accountants, internal auditors

and their staffs from all State agencies; and the management and staff of the Office of the Auditor General. We sincerely appreciate the dedicated efforts of all of these individuals that have allowed Michigan to maintain its position as a national leader in quality and efficiency for financial reporting.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert L. Emerson".

Robert L. Emerson
State Budget Director

A handwritten signature in black ink, appearing to read "Michael J. Moody".

Michael J. Moody, CPA
Director, Office of Financial Management